HYDRO

ANNUAL REPORT 1985

CAT ARM

GENERATING STATION
127,000 KILOWATTS

OPENED BY
THE HONOURABLE
A. BRIAN PECKFORD

NEWFOUNDLAND AND LABRADOR HYDRO

HYDRO

COVER

Plaque unveiled by the Honourable A. Brian Peckford, Premier of Newfoundland and Labrador, at the official opening of the Cat Arm hydroelectric generating plant on June 20, 1985. Lynx, the only wildcat to be seen frequently in Newfoundland, are believed to have been plentiful in the area and it is implied that Cat Arm derived its name from this majestic animal.

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The Newfoundland and Labrador Hydro Act requires the Board of Directors to submit to the Minister an Annual Report containing Financial Statements setting forth the assets and liabilities of the Corporation and giving an account of the activities of the Corporation, as well as setting forth such other matters as may appear to it to be of public interest in relation to the affairs or activities of the Corporation. It is a further requirement of the Act that the Annual Report be presented to the Provincial Legislature.

CORPORATE PROFILE

Newfoundland and Labrador Hydro, the Province's largest Crown Corporation, originated with an Act of the Provincial Legislature passed on June 20, 1954.

Hydro serves the electrical energy needs of the people of Newfoundland and Labrador through the dedicated efforts of more than 1,300 employees. The Hydro Group is one of Newfoundland's largest industrial enterprises and consists of the parent company along with (i) Churchill Falls (Labrador) Corporation Limited, (ii) the Power Distribution District of Newfoundland and Labrador, (iii) the Lower Churchill Development Corporation, (iv) Twin Falls Power Corporation Limited and (v) Gull Island Power Company, Limited.

The Hydro Group is the fourth largest electric utility in Canada in terms of installed capacity (7,000,000 kilowatts) and it ranks in the top fifty Canadian companies in terms of the dollar value of its assets.

On the Island of Newfoundland, Hydro owns and operates hydroelectric plants at Bay D'Espoir (580,000 kW), Hinds Lake (75,000 kW), Godaleich (80,000 kW) and Cat Arm (127,000 kW). In addition, it operates an oil-fired generating station (450,000 kW) at Holyrood and three gas turbines (110,000 kW). In Labrador, Hydro is the majority owner (with Hydro-Quebec) of one of the largest power facilities in the world, located at Churchill Falls (5,400,000 kW). Hydro is also the majority shareholder (with the Government of Canada) of the Lower Churchill Development Corporation which has a mandate to develop the power potential on the Lower Churchill River in Labrador at two separate sites — Gull Island (1,700,000 kW) and Muskrat Falls (600,000 kW).

The Hydro Group maintains approximately 4,000 kilometers of transmission lines on the Island and in Labrador and is the major supplier of electrical energy in the Province. Through the Power Distribution District, it supplies directly over 75,000 people in some 220 communities.

The Consolidated Financial Statements of the Hydro Group of Companies for 1985 show assets of over $2.1 billion, annual sales of approximately $331 million, and annual net income in the area of $29 million.

CORPORATE HIGHLIGHTS — 1985

- Official opening of the 127,000 kilowatt Cat Arm hydroelectric generating plant on June 20th, displacing 1.1 million barrels of Bunker "C" fuel annually.

- Approval by the Public Utilities Board of revised electrical rates for 1986 which allows Hydro to meet its financial objectives, abolishes the Fuel Adjustment Charge and establishes a Rate Stabilization Plan.

- The assumption by Hydro of responsibility for the electric distribution system at Wabush, Labrador and the approval of a plan to gradually move electricity rates in the community to cost recovery levels.

- Record production of 5.28 billion kilowatthours of electrical energy from Hydro's generating facilities on the Island.

- Complete integration of the financial and administrative functions of Churchill Falls (Labrador) Corporation Limited in St. John's with those of Hydro.

- Launching of a major Safety/Loss Control Program throughout the Hydro Group.

CORNERSTONE OF OUR SUCCESS

One of the highlights of the year was the official opening of the Cat Arm hydroelectric generating plant in June by the Premier, Honourable A. Brian Peckford, and the Minister responsible for Hydro, Honourable William W. Marshall. The final capital cost of Cat Arm was $316 million, which was higher than the original estimate of $287 million, but substantially less than estimates made early in the construction period when projections as high as $450 million were made because of record high interest rates and anticipated high inflation rates at the time. Both of these variables declined sharply throughout the construction period.

The completion of Cat Arm was a major step in Hydro's policy of developing economic hydraulic resources on the Island to lessen Newfoundland's dependence on oil-fired thermal sources of electricity generation, now and in the future. The long term solution to Newfoundland's dependence on oil and its associated price and supply uncertainties is, of course, a transmission interconnection between the Island and Labrador. Hydro remains committed to this objective.

STABLE WHOLESALE ELECTRICITY RATES

At the time Hydro made a referral to the Public Utilities Board for a change in its rates to provide for the inclusion of the Cat Arm plant in the rate base, it also proposed that the existing fuel adjustment charge be eliminated and that a Rate Stabilization Plan be established. Hydro felt that this was desirable given the frustration of consumers with high fuel adjustment charges during the previous winter. These unusual charges were due to higher than normal oil-fired thermal generation and very cold temperatures experienced during that winter. The result was that consumers were faced with higher bills not only because of increased seasonal consumption, but also because the fuel adjustment charge effected a substantial increase in the unit price of energy.

Under the new Rate Stabilization Plan which came into effect on January 1, 1986, one wholesale electricity rate will prevail for Hydro's retail customers until July 1987 and the fuel adjustment charge no longer exists. As a result, there will be rate stability and certainty for electricity consumers in the Province, at least in terms of the wholesale price of power. The Rate Stabilization Plan provides for the deferral of cost variances by Hydro resulting from changes in the volume and price of oil consumed and in sales volume. Hydro's rates will be adjusted in 1987 and annually thereafter to amortize the net effect of such changes.

ACCESSING LABRADOR POWER REMAINS A PRIORITY

The long term solution to rising electricity prices in Newfoundland remains an interconnection to Churchill Falls and the undeveloped energy potential of the Churchill River. It is only the uncertainty surrounding the timing of access to this energy which continues to dictate a planning policy which includes sub-optimal solutions. Efforts will be continued to overcome the many barriers which have been erected to prevent access to the energy of the Churchill Falls plant and the Lower Churchill River developments.

HUMAN RESOURCES

A key element in the performance of our organization in 1985 was the "on-the-job" contribution of each and every one of our employees. Collectively and individually, their contributions added up to the organization getting its job done well.

During the year, new records continued to be set in reduced personnel lost time accidents. Of particular significance is the new record set at our Holyrood Thermal Plant of one complete year without a lost time accident. In June, 1985, the Canadian Electrical Association presented the Corporation with a Special Achievement Award

Certificate in recognition of twenty-five percent improvement in the accident frequency rate compared with the previous three years.

A Loss Control Plan first introduced to Hydro in 1984 was also put into place throughout the organization during the past year. It is a management concept which systematically identifies all loss exposures and minimizes the related risks through a properly managed plan involving all employees.

Four separate collective agreements were successfully negotiated at Churchill Falls during the year. The Hotel and Storeworkers were merged with the existing Office and Clerical Workers Unit. The Fire and Security Unit was merged with the newly negotiated Operations Unit. These agreements are subject to renewal during 1987.

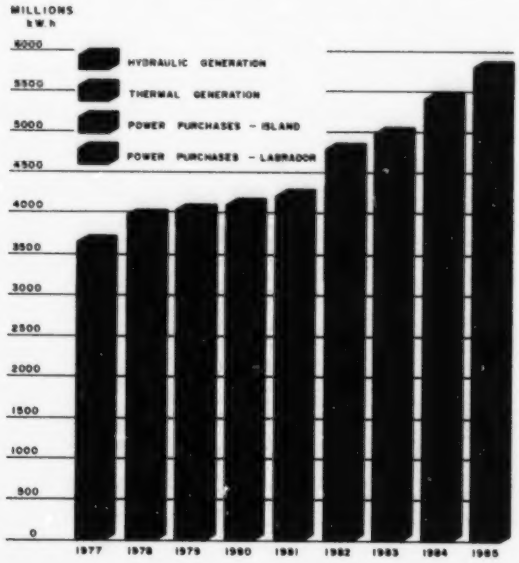
During 1985, the Financial and Administration functions associated with Churchill Falls (Labrador) Corporation in St. John's were totally integrated with those of Hydro and the staff were assigned to positions in the new integrated system.

OPERATIONS

PRODUCTION AND SALES

Production from the Corporation's generating facilities on the Island of Newfoundland totalled 5.28 billion kilowatthours (gross) during 1985, a 7.6% increase over the previous production record set in 1984. In addition to this, 35.7 million kilowatthours were purchased, primarily from the Deer Lake Power Company, for a total electrical energy supply of 5.32 billion kilowatthours.

SYSTEM GENERATION AND ENERGY PURCHASES
HYDRO OPERATIONS

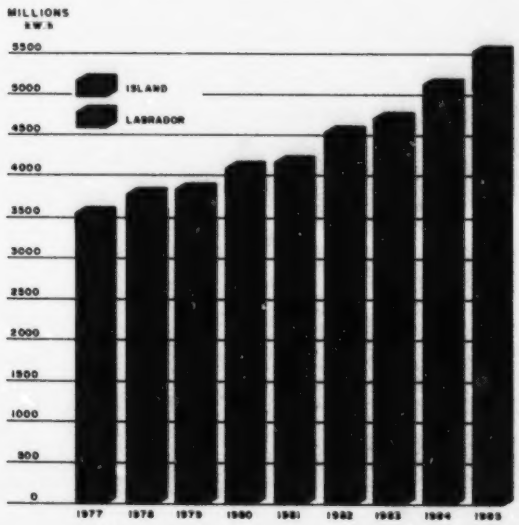


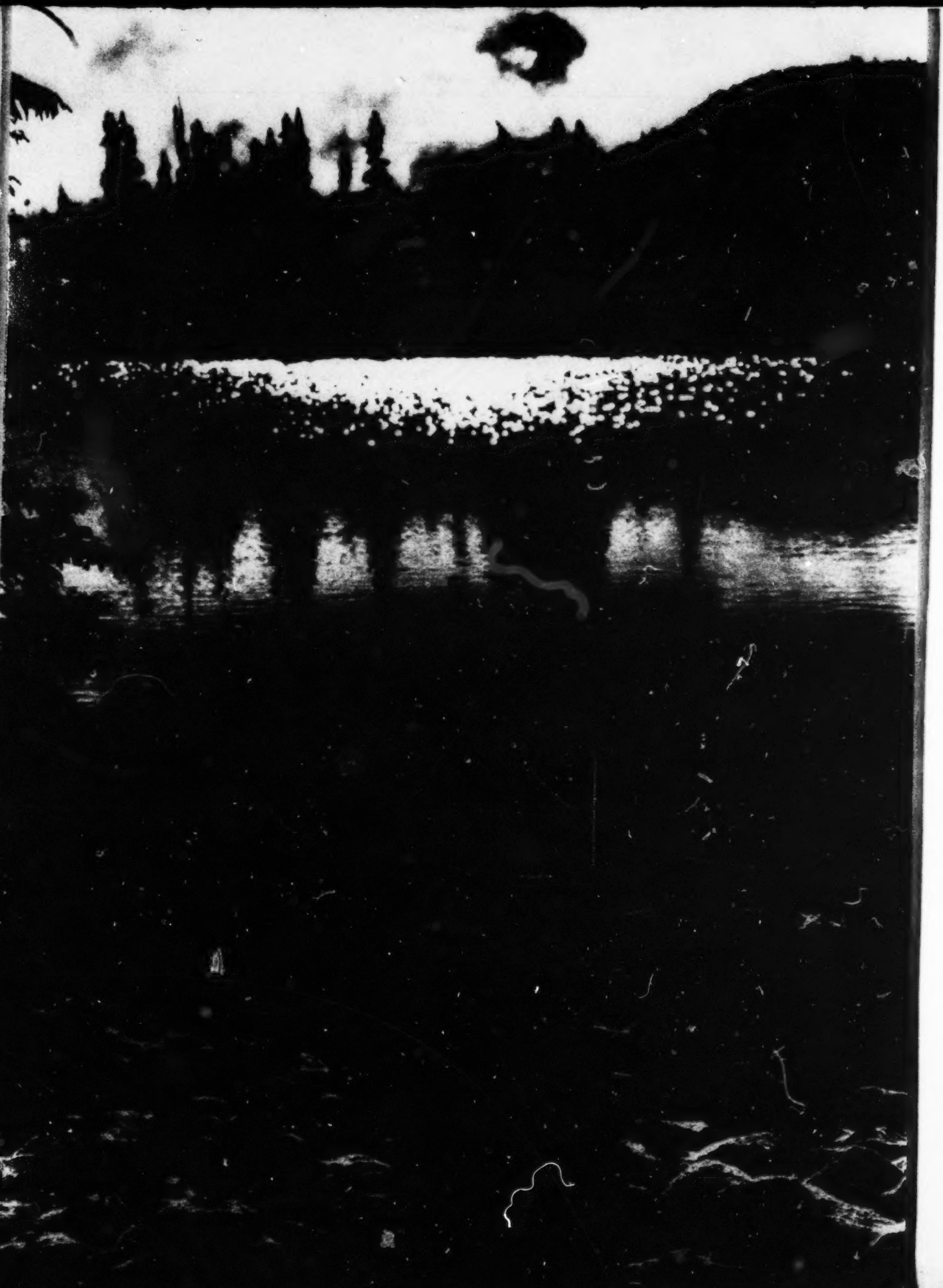
Near record low water inflows into the reservoirs of hydroelectric facilities during the latter half of the year resulted in a lower than average hydroelectric production for 1985. A total of 3.46 billion kilowatthours was produced, of which 2.26 billion kilowatthours was generated at Bay D'Espoir, 282.1 million kilowatthours at Hinds Lake, 513.6 million kilowatthours at Godaleich (Upper Salmon) and 388.6 million kilowatthours was generated at Cat Arm.

This low hydroelectric production was largely responsible for a record 125% increase in energy production from the Holyrood oil-fired thermal station over the 1984 production level. A total of 2.8 million barrels of fuel was burned in 1985 compared to 1.3 million barrels in 1984. Production from Holyrood and our gas turbine and diesel facilities totalled 1.82 billion kilowatthours (gross). In 1985 hydroelectric generation comprised 65% of the total energy supply, thermal generation 34% and purchases 1%.

Energy sales to our Island customers reached a new record of 5.06 billion kilowatthours, representing a 6.1% increase over 1984. Sales to Labrador customers totalled 451.7 million kWh, an increase of 34.9% over 1984. This increase was due primarily to increased sales to the Iron Ore Company in Labrador City and to the Town of Wabush. The system peak for the year was 1,009,000 kilowatts and occurred on March 5th.

ENERGY SALES
HYDRO OPERATIONS

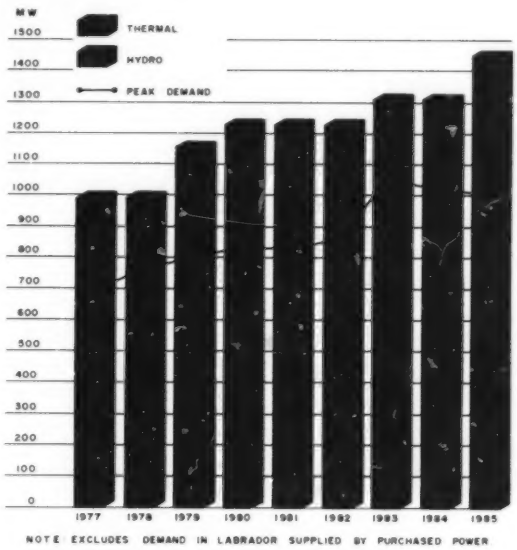




RURAL POWER SYSTEMS

Hydro provides operational services for the Power Distribution District of Newfoundland and Labrador (PDD) which is responsible for the Rural Electrification Program within the Province. PDD serves 75,000 people in rural communities either by (i) purchasing power from the main hydro power grid and distributing it to its interconnected customers, or (ii) for more remote areas, supplying electricity directly to its customers from local diesel generators.

GENERATING CAPACITY AND DEMAND
HYDRO OPERATIONS



NOTE EXCLUDES DEMAND IN LABRADOR SUPPLIED BY PURCHASED POWER

Sales by PDD to Island interconnected customers in 1985 were 206.9 million kilowatthours, a decrease of 1.5% from the 1984 level. Sales to customers on the isolated diesel systems, both on the Island and in Labrador, were 85.2 million kilowatthours, an increase of 4.2% from 1984. Sales to Labrador interconnected customers totalled 101.6 million kilowatthours, an increase of 22.1%.

On September 1, 1985, PDD acquired ownership and responsibility from Wabush Mines for the operation of the distribution system in the Town of Wabush, Labrador. This has added approximately 1000 new customers to PDD's system. PDD is currently in the process of a major upgrading program for this distribution system, the total cost of which is estimated at $3 million.

During the latter half of 1985, PDD initiated construction of a distribution line from Charlottetown to the community of Pinsent's Arm on the Southern Coast of Labrador. When this project is completed in early 1986, it will provide electrical power to this community for the first time.

In August, 1984, PDD initiated an efficiency program for the operation of its fully-manned diesel plants. Savings of $214,000 were achieved during 1985, which exceeded the programs target of $182,000 by 18%. This fuel efficiency program has now been extended to include all diesel plants.

PDD capital expenditures for 1985 were $7.9 million. Of this amount, $0.5 million was spent on generating facilities and $7.4 million on upgrading and extensions to the distributions systems to meet increasing power demands of customers. Revenue from PDD customers is not sufficient to meet the high operating costs and the Provincial Government provides an annual payment to PDD in the order of $23 million to make up the revenue shortfall.

PRODUCTION — CHURCHILL FALLS OPERATIONS

Total production for the Churchill Falls plant for the year was 34.9 billion kilowatthours which was 10.5% lower than the 39.0 billion kilowatthours generated in 1984 and 9% lower than the average for the past seven years of 38.4 billion kilowatthours. Sales to Hydro-Quebec were 11.7% lower than in 1984 and 11% lower than the average for the past seven years. Domestic

and industrial sales in Labrador totalled 2.3 billion kilowatthours, or an increase of 4.5% over 1984.

The total run-off for the Churchill Falls reservoirs during 1985 was 35.9 million cubic meters which was 20% lower than 1984 and 22.2% lower than the twenty-eight year average. At the start of the drawdown season in September, the reservoirs were only 68% full. For the fourth consecutive year, reservoir levels were managed without spilling any water.

On September 17th a stator fault occurred in Unit No. 4. After investigation it was concluded that the stator would have to be completely rewound. Work on rewinding commenced on November 5th and it is estimated that the unit will be back in service by the end of April, 1986.

Also on September 30th the main transformer for Unit No. 1, which is located underground, failed in service. This transformer was replaced by the spare transformer and the faulted one was shipped to the manufacturer's plant for repair. This transformer is being rewound and is expected back in Churchill Falls in September, 1986.

During the year six units had their rated capacity formally upgraded; five units due to manufacturer's rerating and one unit due to stator rewind. The new rated capacity of the Churchill Falls Plant is increased to 5,403,500 kilowatts from the originally installed 5,225,000 kilowatts. As in past years, the maximum power generated exceeded 5,600,000 kilowatts.

RATES

In August 1985, Hydro filed an application with the Public Utilities Board (PUB) requesting that its rates to retail customers be changed to include the financing and operating costs associated with the Cat Arm hydroelectric project. This request was approved with effect from January 1, 1986. Hydro also requested that the fuel adjustment charge be eliminated from its energy pricing structure and that it be replaced by a Rate Stabilization Plan which would account for changes in fuel prices and levels of rainfall, from those used in the Cost of Service Study.

The PUB approved Hydro's recommendation regarding the elimination of the fuel adjustment charge and as well approved a modified version of the Rate Stabilization Plan for retailers which also came into effect on January 1, 1986.

The Rate Stabilization Plan will accumulate differences in fuel prices, levels of rainfall and load from those estimated by Hydro. The rates to Hydro's retail customers will be revised on July 1, 1987. The balance in the Plan at that time will be amortized over a three year period. Retail rates could increase or decrease on that date depending on whether the balance in the Plan is positive or negative.

A similar Rate Stabilization Plan has been approved for Hydro's industrial customers and industrial rates will remain constant for 1986 and 1987. Any adjustments required in the industrial rates to amortize the balance in the Rate Stabilization Plan or other cost factors, will be made on January 1, 1988.

The overall effect of the elimination of the fuel adjustment charge and the implementation of Rate Stabilization Plans is to provide a stable rate structure to Hydro's retail and industrial customers. Consumers can now budget for their electricity costs without having their rates affected by climatic conditions or changes in fuel prices, both of which are beyond the control of any utility.

CONSTRUCTION

The official opening of the Cat Arm Hydro-Electric Project marked the highlight of the Corporation's construction program during the year. Construction activity throughout 1985 was substantially reduced in comparison to former years due to the completion of Hydro's present generation expansion program. The total capital expenditures for the year amounted to $35.4 million. The following is a breakdown of these expenditures:

	$ millions
Generation	25.1
Transmission and Terminals	1.3
Other Facilities	9.0
Total	$35.4

CAT ARM

The commissioning activities associated with the Cat Arm Project were completed in May and the generation facility was officially opened on June 20th. The successful completion of this project has increased the capability of the Island's generating system by 127 MW and 676 GWH annually. The generating facility has the capability of displacing 1,100,000 barrels of Bunker "C" fuel each and every year.

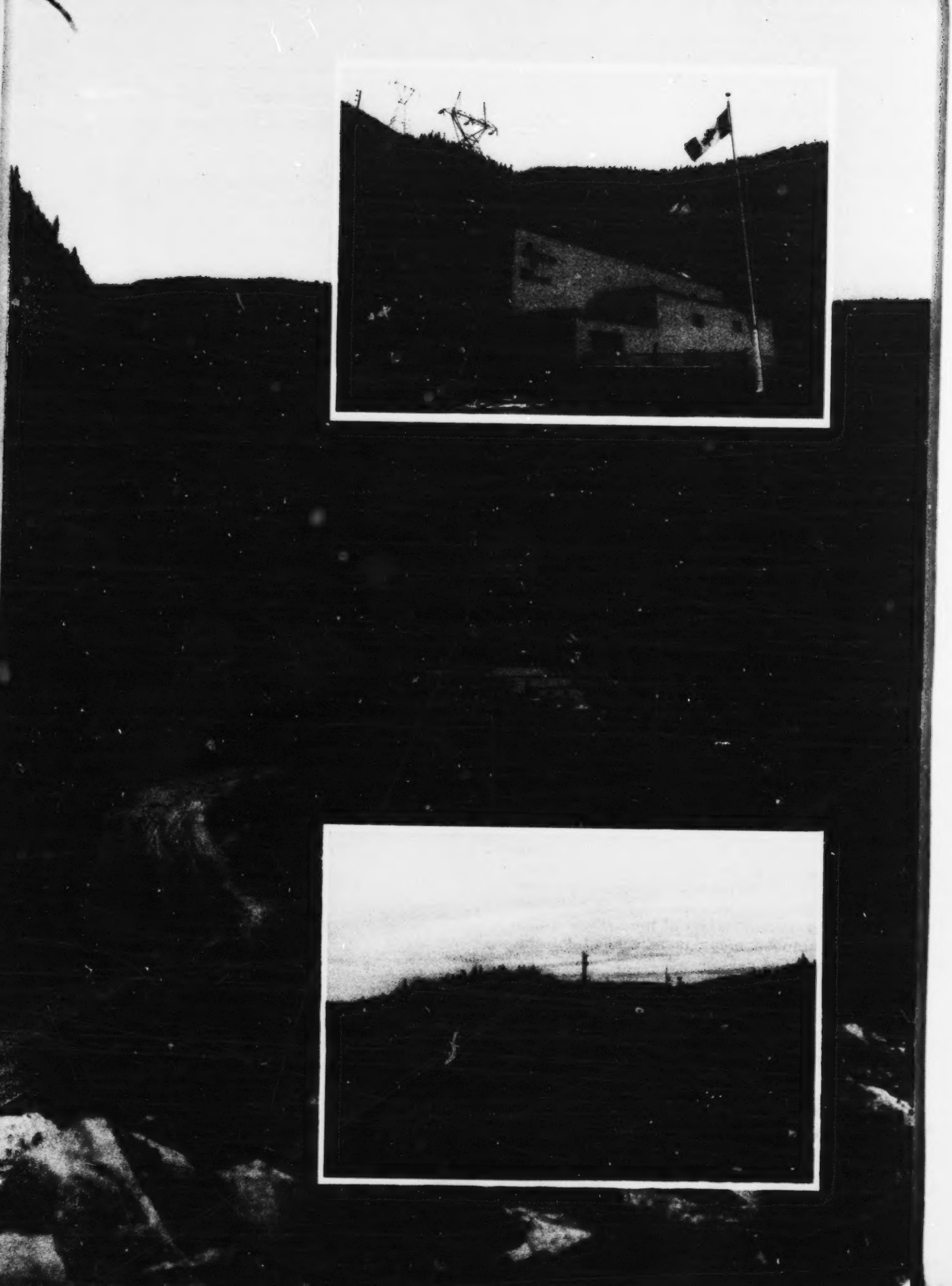
Clean-up and rehabilitation was initiated during the Summer and continued throughout the remainder of the year. A grass cover was established on approximately 6.5 hectares of the three main borrow areas to prevent erosion and approximately 17,000 black spruce seedlings were planted to further enhance these disturbed areas. Rehabilitation at the campsite and powerhouse areas is scheduled for the Summer of 1986.

Over the 3.5 year construction period, the project had a positive economic impact, as it provided approximately 1600 man years of work. The workforce peaked at 800 persons and had a total payroll of approximately $60 million.

The project was completed within schedule and at a final capital cost of $316 million, which was substantially less than earlier projections but higher by 10% than the original estimate.

ENGINEERING

During the year under review, Engineering activity centered in the following areas: (i) design for major terminal station expansions which will be constructed over the next several years; (ii) prefeasibility studies relating to small hydro developments and investigations pertaining to potential diversions into existing watersheds; (iii) derivation of capital costs, construction schedules and route selection for several transmission extensions associated with the interconnection of several isolated diesel areas with the Island transmission grid. In addition, Hydro provided the engineering services associated with the design requirements for the water supplies from the generating station to the Fish Hatchery at Bay D'Espoir.



FINANCIAL REVIEW

CONSOLIDATED FINANCIAL PERFORMANCE

NET INCOME

Hydro's net income in 1985 was $15.0 million while its share of CFLCo's net income was $14.1 million for a total consolidated net income of $29.1 million. Consolidated net income is down $21.8 million from 1984 primarily because of a decrease in CFLCo's net income due to the recording by CFLCo in 1984 of an adjustment which arose from an eight year review of power sales as provided for in its Power Contract with Hydro-Quebec.

REVENUE

Gross revenue in 1985 was $330.6 million, with $323.7 million coming from energy sales which increased by $54.8 million, or 20.4% over 1984.

The 1985 sales volume to retail and industrial customers increased by 9.2% and 5.4% respectively, resulting in a combined revenue increase of $12.9 million. However, the prime increase in revenues from these customers was because of increased fuel escalation charges related to production increases from oil-fired generation. Export sales revenue decreased by $2.9 million or 3.1% from 1984 due to an 11.6% decrease in the volume of sales.

EXPENSES

Total expenditures in 1985 amounted to $290.5 million compared to $241.4 million in 1984, an increase of 20.3%.

Energy related costs for fuel and purchased power were $95.7 million in 1985, up $44.4 million (86.5%) from 1984. This increase was primarily due to the increased thermal generation in 1985 which in turn was due to lower than normal inflows into Hydro's reservoirs. The cost of fuel oil was also 9.1% higher in 1985.

Operations and administration costs amounted to $50.4 million in 1985 which is $0.4 million less than 1984. Net interest expense charged to operations in 1985 was $121.4 million, up $4.4 million (3.8%) from 1984 and is primarily the result of the Cat Arm plant coming on stream.

CAPITAL EXPENDITURES

Capital expenditures in 1985 amounted to $35.4 million for the Hydro Group and were mainly associated with the completion of the Cat Arm Development.

CFLCo

Hydro's income from CFLCo consisted of $25.0 million (1984 - $46.2 million), representing its share of CFLCo's earnings plus rentals and royalties of $5.4 million (1984 - $8.5 million) less interest on the debt to finance the investment in CFLCo of $16.4 million (1984 - $23.5 million). This resulted in net income to Hydro in 1985 of $14.1 million (1984 - $31.2 million). During 1985, CFLCo paid dividends of $23.2 million to Newfoundland and Labrador Hydro and $9.5 million to Hydro-Quebec.

FINANCIAL INFORMATION
DECEMBER 31, 1985
($ Millions)

	Hydro	CFLCo	TOTAL
Revenue	231.6	95.7	327.3
Expenses:			
Operations & Administration	27.5	22.9	50.4
Fuels	95.1	—	95.1
Power purchased	3.1	—	3.1
Depreciation	8.5	13.3	21.8
Interest	82.4	22.3	104.7
	216.6	58.5	275.1
Net Operating Income	15.0	37.2	52.2
Interest on CFLCo Acquisition & Other Dedicated Costs	—	(12.1)	(12.1)
Minority Interest	—	(11.0)	(11.0)
Net Income To Hydro	15.0	14.1	29.1

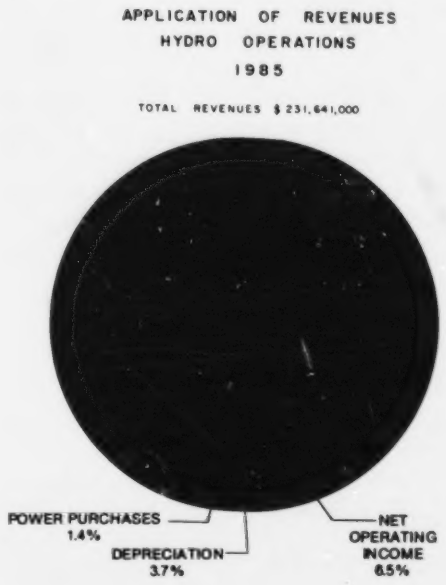
The above information reflects the financial results of each corporate entity. Certain figures differ from the Consolidated Statement of Income due to various inter-company transactions which are eliminated upon consolidation.

FINANCIAL PERFORMANCE — HYDRO OPERATIONS

In 1985, Hydro continued the restraint program on capital and operating expenditures instituted in the second half of 1982. The debt:equity ratio improved slightly over 1984 but the interest coverage deteriorated primarily because of the costs associated with the Cat Arm Project, which came into service on August 1, 1985. A comparison of Hydro's primary financial ratios for the past five years are:

Financial Measurements:	1985	1984	1983	1982	1981
Interest coverage	1.13	1.19	1.16	1.22	1.21
Debt:Equity Ratio	90/10	91/9	92/8	93/7	94/6

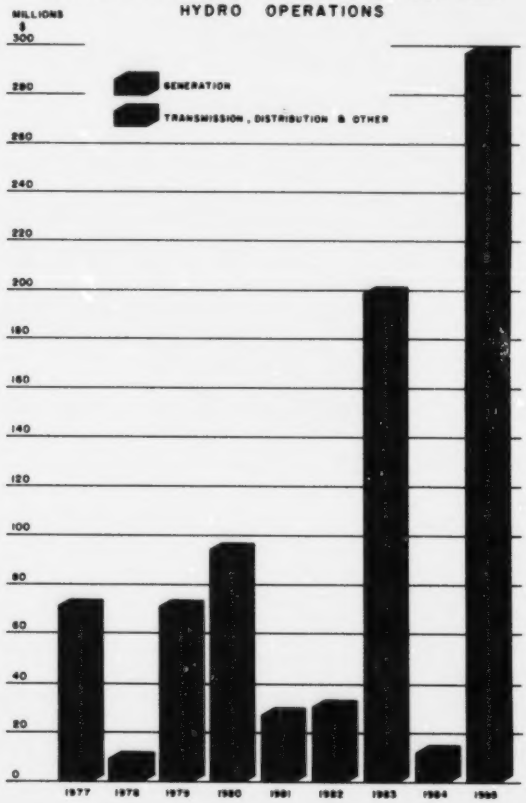
During 1985, Hydro referred a request to change its wholesale rates applicable to its retail customers to the PUB. The change in rates was required to cover the increase in operating expenses as a result of the Cat Arm Project coming into service in August 1985 and to alter the rate structure to include all fuel costs in the basic rate. Prior to this referral, only a small portion of fuel costs were included in the basic rate and the balance was charged directly to Hydro's customers when incurred as a fuel adjustment charge. The referral also covered the elimination of the water equalization provision and the setting up of a Rate Stabilization Plan to account for variations in water conditions and fuel costs.



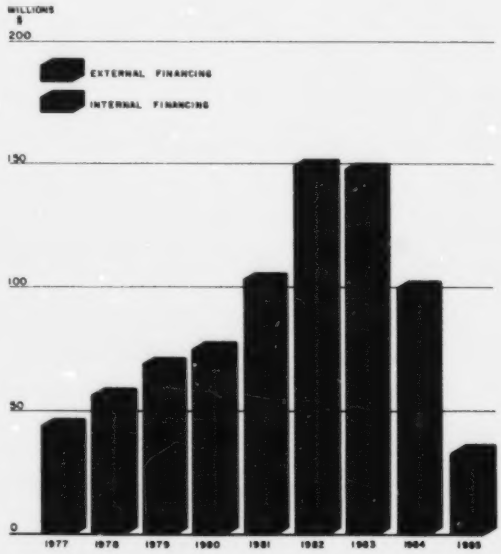
The PUB recommended the proposed increase in the basic rate, the alteration of the rate structure to include all fuel costs in the basic rate, the elimination of the water equalization provision and the creation of a Rate Stabilization Plan effective January 1, 1986.

Hydro's capital program declined significantly in 1985 primarily due to the completion of the Cat Arm Project and will continue at a lowered level until construction begins on the next major source of generation. During the year the $37.9 million which had been raised in Japan on a short term basis in 1984 was converted to a long term loan with interest at 7.6%. At year end, $102.4 million of Hydro's promissory notes was outstanding in the Canadian short term money market at an average rate of 9.9% with terms of up to 324 days.

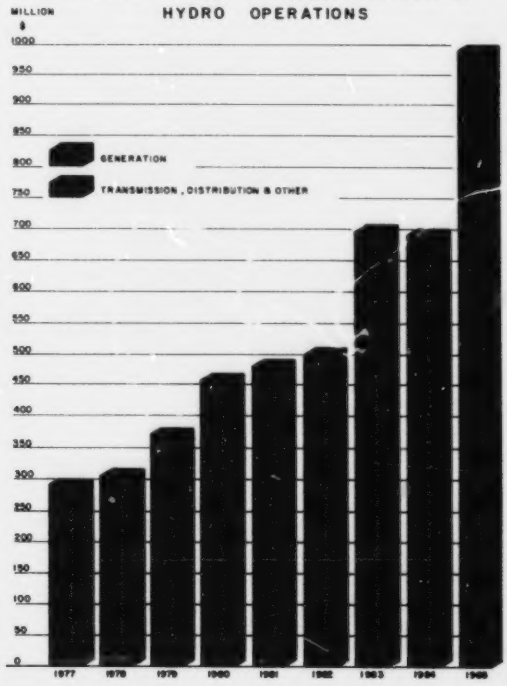
ADDITIONS TO PROPERTY, PLANT AND EQUIPMENT
HYDRO OPERATIONS



FINANCING OF CAPITAL EXPENDITURES
HYDRO OPERATIONS



NET BOOK VALUE OF ASSETS IN SERVICE
HYDRO OPERATIONS



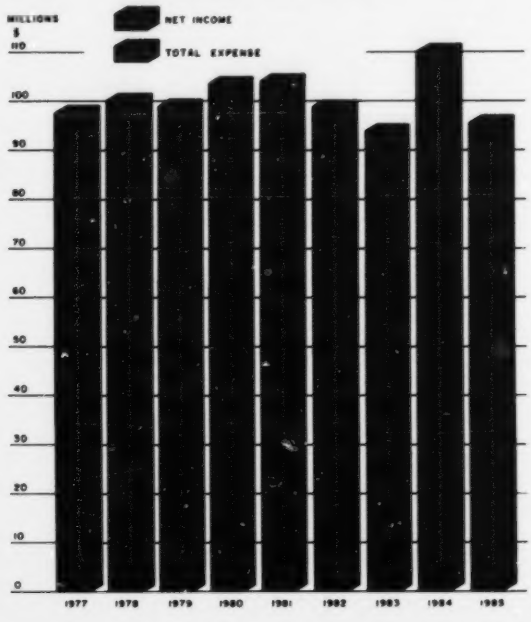
FINANCIAL PERFORMANCE — CFLCo OPERATIONS

Revenue from energy sales in 1985 amounted to $94.4 million and of this amount, 96.4% represents revenue from sales to Hydro-Quebec with the remainder of the sales being made to Newfoundland and Labrador Hydro and Twin Falls Power Corporation Limited. This represents a decrease of $2.8 million when compared to 1984 and is primarily due to a 11.6% decrease in the volume of sales to Hydro-Quebec.

Operating expenses for the year excluding rental and royalties, interest and depreciation amounted to $17.5 million compared with $17.4 million in 1984 and reflect the continuation of the restraint program adopted in 1982.

Net interest and exchange expense in 1985 amounted to $22.3 million compared with $1.0 million in 1984. This major increase results directly from the recording in 1984 of interest income totalling $24.4 million which arose from the review of power sales during the preceding eight years as provided for in the Power Contract with Hydro-Quebec.

COMPOSITION OF TOTAL REVENUE
CHURCHILL FALLS OPERATIONS



MANAGEMENT REPORT

The consolidated financial statements of Newfoundland and Labrador Hydro have been prepared by management in accordance with Canadian generally accepted accounting principles consistently applied and including information available up to March 7, 1986. The integrity and objectivity of the data in these financial statements, including estimates and judgments relating to matters not concluded by year end, are the responsibility of management. Financial information presented elsewhere in the Annual Report is consistent with that in the consolidated financial statements.

Management maintains systems of internal accounting controls and procedures to provide reasonable assurance at reasonable cost that its assets are safeguarded against loss from unauthorized use or disposition and that the financial records provide a reliable basis for the preparation of financial statements and other data, as well as maintaining accountability for corporate assets.

Hydro's independent auditors provide an objective, independent review of management's discharge of their responsibilities as they relate to the fairness of reported consolidated operating results and financial conditions of Hydro in accordance with generally accepted auditing standards.

The Board of Directors pursues its responsibility for these financial statements principally through its Audit Committee, composed solely of outside directors, which meets periodically with management as well as with the internal and independent auditors who have full and free access to the Audit Committee, and meet with it, with and without management being present, to discuss auditing and financial reporting matters.

Management is responsible for and the Board of Directors has approved, all of the information in the Annual Report.

Cyril J. Abery
Vice-Chairman of the Board,
President and Chief Executive Officer

Vice-President, Finance and
Chief Financial Officer

March 7, 1986
St. John's, Newfoundland

Newfoundland and Consolidated

(in thousands

Assets

	December 31	
	1985	1984
Fixed assets (Note 2)		
Property, plant and equipment	$1,900,274	1,889,733
Current assets		
Cash and term deposits	43,892	50,149
Receivables	52,359	54,498
Water equalization receivable (Note 9)	7,843	—
Fuel and supplies at average cost	32,957	29,436
Prepaid expenses	3,368	1,345
	140,419	135,428
Long-term receivables (Notes 3 and 11(b))	25,260	37,240
Investment in Twin Falls Power Corporation Limited (Note 4)	3,456	2,903
Lower Churchill option (Note 5)	5,200	5,200
Deferred charges (Note 6)	29,818	32,418
	$2,104,427	2,102,922

Labrador Hydro
Balance Sheet

of dollars)

Liabilities and Shareholder's Equity

	December 31	
	1985	1984
Long-term debt (Notes 8 and 10)	$1,411,392	1,474,300
Current liabilities		
Accounts payable and accrued liabilities	24,837	32,684
Water equalization refundable (Note 9)	16,234	—
Accrued interest	32,618	30,886
Long-term debt due within one year	48,166	28,493
Promissory notes (Note 10)	102,380	76,403
	224,235	168,466
Water equalization refundable (Note 9)	14,033	—
Provision for water equalization	—	36,000
Minority interest in Churchill Falls (Labrador) Corporation Limited	102,023	100,477
Minority interest in Lower Churchill Development Corporation Limited	14,750	14,750
Shareholder's equity		
Share capital		
Common shares of par value of $1 each. Authorized 25,000,000 shares; issued 22,503,942 shares	22,504	22,504
Contributed capital (Note 5)		
Lower Churchill Development	15,400	15,400
Muskrat Falls Project	2,165	2,165
Gull Island Project	100,000	100,000
Retained earnings	197,925	168,860
	337,994	308,929
	$2,104,427	2,102,922

See accompanying notes

On behalf of the Board

Cyril J. Abery
Director

Edward M. Hearn
Director

Newfoundland and Labrador Hydro
Consolidated Statements

(in thousands of dollars)

Income

	For the year ended December 31	
	1985	1984
Revenue		
Energy sales	$323,707	268,940
Rentals and royalties	5,378	8,534
Other	1,473	1,664
	330,558	279,138
Expenses		
Operations and administration	50,400	50,840
Fuels	95,059	49,365
Power purchased	660	1,941
Depreciation	22,948	22,299
Interest (Note 12)	121,418	116,978
	290,485	241,423
Net income from operations	40,073	37,715
Unusual item		
Sale of power adjustment (Note 11(b))	—	35,276
Net income before minority interest	40,073	72,991
Minority interest	11,008	22,084
Net income for the year	$ 29,065	50,907

Retained Earnings

	For the year ended December 31	
	1985	1984
Balance beginning of year	$168,860	117,953
Net income for the year	29,065	50,907
Balance end of year	$197,925	168,860

Changes in Financial Position

	For the year ended December 31	
	1985	1984
Funds provided		
From operations		
Net income	$ 40,073	37,715
Add (deduct) items not requiring working capital		
Depreciation	22,948	22,299
Water equalization	(5,733)	7,930
Amortization of deferred exchange loss	507	409
Other amortization	2,620	2,471
Other	(456)	(328)
Funds provided by operations	59,959	70,496
Sale of power adjustment	—	35,276
Proceeds of long-term debt	37,349	72,934
Decrease in long-term receivable	12,253	—
Dividends received from Twin Falls Power Corporation Limited	—	798
Miscellaneous	1,817	2,115
Total funds provided	111,378	181,619
Funds applied		
Increase in long-term receivable	273	29,397
Additions to fixed assets	35,403	100,236
Reduction in long-term debt	100,257	38,911
Dividends paid by a subsidiary to a minority interest	9,462	7,787
Increase in deferred charges	527	2,843
Reduction in water equalization	16,234	794
Total funds applied	162,156	179,968
(Decrease) increase in working capital	(50,778)	1,651
Working capital (deficiency) beginning of year	(33,038)	(34,689)
Working capital (deficiency) end of year	$(83,816)	(33,038)

See accompanying notes

Newfoundland and Labrador Hydro
Notes to Consolidated Financial Statements
December 31, 1985

Newfoundland and Labrador Hydro ("Hydro") is incorporated under a special act of the Legislature of the Province of Newfoundland (the "Province") as a Crown corporation and its principal activity is the development, generation and sale of electric power. Hydro and its subsidiary companies are exempt from paying income taxes under Section 149(1)(d) of the Income Tax Act.

1. **Summary of Significant Accounting Policies**

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles as established in Canada. In order to match revenues and costs and to conform with recommendations of the Board of Commissioners of Public Utilities ("PUB"), Hydro's accounting for foreign exchange differs from that recommended by the Canadian Institute of Chartered Accountants.

Rates and regulations (excluding sales by subsidiaries)

The rates charged by Hydro, excluding sales by subsidiaries, are governed by the Electrical Power Control Act (the "Act"). Under the Act, Hydro is required to charge rates to all its customers designed "to recover the cost of service provided by it and a margin of profit sufficient to achieve and maintain a sound financial position so it is able to achieve and maintain a sound credit rating in the financial markets of the world". There are presently four long-term contracts with industrial customers which were entered into prior to the coming into being of the Act and which do not allow Hydro to recover costs plus a margin of profit and therefore require payments from the Province to Hydro in order to ensure that Hydro meets the requirements of the Act. These payments were $25,968,000 for the year ended December 31, 1985 (1984 $17,800,000).

Rates proposed for utility customers from which approximately 68.4% of Hydro's revenue is derived (1984 67.7%) are subject to public hearings, following which the PUB recommends rates to the Province. If the Province does not change the rates recommended by the PUB within 15 days, the recommended rates become effective. Should the Province approve rates which are lower than those recommended by the PUB, the Act requires the Province to enter into financial and other arrangements as may be necessary to enable Hydro to conform to the Act quoted above. The Province has accepted all rate recommendations of the PUB to date. Rates, compatible with the Act, charged to industrial customers, are set by the Board of Directors of Hydro. The PUB has determined that Hydro's net income from operations should provide coverage of from 1.15 times to 1.25 times its gross interest cost in order to achieve the profit margin required by the Act. The coverage from operations in 1985 was 1.13 (1984 1.19).

Principles of consolidation

The consolidated balance sheet includes the accounts of Hydro and those of its subsidiary companies, Churchill Falls (Labrador) Corporation Limited ("CF(L)Co"), (65.8% owned), Gull Island Power Company Limited ("GIPCo"), (100% owned) and Lower Churchill Development Corporation Limited ("LCDC"), (51% owned).

CF(L)Co is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador and having a rated capacity of 5,400,000 kilowatts ("kW") (the "CF(L)Co Project").

The cost of the investment in CF(L)Co exceeds the equity in the book value of the net assets acquired by $77,148,000. This amount is assigned to property, plant and equipment and is being written off on a straight-line basis at the rate of 1-1/2% per annum. As at December 31, 1985 $12,729,000 (1984 $11,571,000) had been written off.

Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, (the "Lease"), CF(L)Co must pay rentals and royalties to the Province annually. These rentals and royalties have been assigned to Hydro.

A portion of Hydro's shareholding in CF(L)Co is deposited in a voting trust pursuant to an agreement with Hydro-Quebec.

GIPCo is incorporated under the laws of Canada and was established with the objective of developing the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and of constructing a direct current transmission system from Labrador to the island of Newfoundland (the "Gull Island Project"). (See Note 5)

LCDC is incorporated under the laws of Newfoundland and was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River (the "Lower Churchill Development"). (See Note 5)

CF(L)Co owns voting control (66-2/3%) of Twin Falls Power Corporation Limited ("TWINCo"), but only a 33-1/3% equity interest, and as the principal assets and credit resources of TWINCo cannot be transferred to CF(L)Co, consolidation is not considered appropriate and the investment is carried on an equity basis.

Fixed assets and depreciation

Expenditures for additions, improvements and renewals are capitalized and normal expenditures for maintenance and repairs are charged to operations.

Hydro, GIPCo and LCDC

Plant under construction includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to plant under construction at rates equivalent to the weighted average cost of the most recent funds borrowed. The average rate for the year ended December 31, 1985 was 11-3/5% (1984 13-1/2%).

Depreciation is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Depreciation on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation	
Hydraulic	50, 75 and 100 years
Thermal electric	25 and 30 years
Diesel electric	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution System	30 years

CF(L)Co

Depreciation is provided for at a rate of 1-1/2% per annum on a straight-line basis.

Deferred charges

Debt discount and financing expenses

These costs are, in general, amortized on a straight-line basis over the lives of the respective debt issues.

Deferred foreign exchange loss

CF(L)Co's unrealized foreign exchange losses, net of accumulated charges to income, are amortized over the remaining life of the related long-term debt.

Deferral of major repairs

Subject to PUB approval, cost of major repairs of an extraordinary and non-recurring nature are amortized to income over periods ranging from five to ten years commencing in the year in which they are incurred. The PUB has accepted the inclusion of these charges in determining Hydro's regulated rates.

Feasibility studies and other

These costs are amortized on a straight-line basis over a five year period.

Provision for water equalization

In order to equalize the effect on thermal generation cost due to fluctuations in water availability, Hydro charged or credited fuel expense in the income statement annually with an amount calculated to adjust generation costs to an average annual water condition. The calculation was based on historical water flow data compiled over a period of 36 years. The offsetting debit or credit was included in the water equalization provision account. This practice was accepted by the PUB in determining Hydro's regulated rates.

Hydro, with PUB concurrence, concluded that the provision should have an upper limit of $36,000,000, and that this amount would be sufficient to absorb the adverse effects of a recurrence of the three consecutive driest years ever recorded. (See Note 9)

Foreign currencies

CF(L)Co changed its accounting policy with respect to foreign currency translation prospectively from January 1, 1984 to conform with the recommendations of the Canadian Institute of Chartered Accountants.

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At each balance sheet date monetary assets and liabilities are translated using exchange rates at that date except for long-term debt and its related current portions which are accounted for as follows:

(i) In the case of Hydro, long-term debt, including current portion, is translated at exchange rates prevailing when the debt was incurred, in accordance with rate making practices. In 1983, the PUB recommended that should Hydro's earnings in any year be insufficient to yield Hydro's minimum profit margin and also meet a realized foreign exchange loss, the PUB, on a rate referral from Hydro, would recommend that the deficiency be amortized over a reasonable period of time. In 1985, the PUB accepted the inclusion of foreign exchange losses in rates charged to customers commencing in 1986. Any realized foreign exchange loss not recovered due to the operation of the rate setting process will be deferred to the time of the next rate hearing for inclusion in the new rates set at that time. Therefore, no recognition is given in the accounts to unrealized gains or losses.

(ii) Under the provisions of the contract between CF(L)Co and Hydro-Quebec (the "Power Contract") CF(L)Co's exposure for foreign exchange losses is limited. CF(L)Co recovers a portion of the difference between actual exchange rates prevailing at the settlement date of its First Mortgage Bonds and a Weighted Average Exchange Rate as defined in the Power Contract.

The unrealized foreign exchange loss not recoverable under the Power Contract has been deferred and is being amortized to operations over the remaining life of the debt.

(c) Gains or losses arising in the translation or conversion of foreign currencies are included with interest in the statement of income.

2. **Fixed Assets**

	1985	1984
	(000)	(000)
Hydro		
Property, plant and equipment, at cost	$1,121,895	826,055
Less contributions in aid of construction	71,895	71,149
	1,050,000	754,906
Less accumulated depreciation	73,148	63,678
	976,852	691,228
Plant under construction	7,084	269,390
	983,936	960,618
GIPCo		
Gull Island Project, at cost (Note 5)	98,692	98,665
CF(L)Co (a)		
Property, plant and equipment, at cost	961,743	961,012
Less accumulated depreciation	168,324	154,726
	793,419	806,286
LCDC		
Capital studies (Note 5)	24,227	24,164
	$1,900,274	1,889,733

(a) CF(L)Co assets are pledged as security for its long-term debt.

3. **Long-Term Receivables**

	1985	1984
	(000)	(000)
Hydro (Note 9)	$ —	7,843
CF(L)Co	25,260	29,397
	$25,260	37,240

The receivable for CF(L)Co relates to the additional revenue referred to in Note 11(b) plus interest. Payments of the amount related to the initial 8 year review period will be received in monthly instalments over an eight year period which commenced September 1, 1984. The receivable bears interest at 7% per annum from September 1, 1984, which interest is payable concurrently with each instalment.

4. **Investment in Twin Falls Power Corporation Limited**

	1985	1984
	(000)	(000)
Shares, at cost	$2,500	2,500
Equity in retained earnings beginning of year	403	398
Equity in net income for the year	553	803
Dividends for the year	—	(798)
	$3,456	2,903

5. **Lower Churchill Development**

LCDC was incorporated in 1978 pursuant to the provisions of an agreement (the "Principal Agreement"), between the Province and the Government of Canada. The Province and the government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as nearly as possible, this ratio of beneficial ownership. Hydro is the designate for the Province's shareholding in LCDC.

Upon agreement to continue with the Lower Churchill Develop-

ment, GIPCo's assets and the hydroelectric development rights to the Lower Churchill River, (the "Water Rights"), will be acquired by LCDC pursuant to the provisions of an agreement between LCDC and the Province, (the "Option Agreement"). The purchase price in respect of GIPCo's assets will be a maximum of $100,000,000 less $5,200,000 representing the value assigned to 520 Class A common shares of LCDC issued pursuant to the signing of the Option Agreement. As consideration for GIPCO's assets, LCDC will issue a 10% Convertible Demand Debenture in the amount of $94,800,000. LCDC will issue 3,000 Class B common shares, without nominal or par value, to the Province in consideration of the Water Rights and the Province will transfer such shares to Hydro. The Option Agreement expires November 24, 1987 and it is not anticipated that there will be any loss upon sale of GIPCo's assets to LCDC.

Hydro has acquired 1,540 Class A common shares of LCDC which have a stated value of $10,000 each. 520 shares were acquired in 1979 pursuant to signing of the Option Agreement and 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

In 1980, the LCDC Board of Directors issued a report to the shareholders recommending development of the Muskrat Falls site and the transmission of this power to the island of Newfoundland. Engineering studies for the transmission system have been completed but a final commitment to the project awaits the resolution of the Churchill Falls issues. (See Note 13(a))

6. **Deferred Charges**

	1985	1984
	(000)	(000)
Unamortized debt discount	$15,389	16,810
Deferred foreign exchange loss (CF(L)Co)	11,709	12,216
Major repair costs	1,344	1,759
Feasibility studies and other	1,376	1,633
	$29,818	32,418

7. **Power Distribution District**

Hydro administers the Power Distribution District of Newfoundland and Labrador ("PDD"), a statutory corporation of the Province. PDD is responsible for the provision of electricity to its customers in certain remote rural communities. Hydro finances the capital requirements of PDD, manages PDD's operating responsibilities and is fully reimbursed for all costs associated therewith.

8. **Long-Term Debt**

	1985			1984
	Hydro	CF(L)Co	Total	Total
	(000)	(000)	(000)	(000)
Summary of long-term debt				
Bonds, notes and debentures	$808,090	520,444	1,328,534	1,389,502
Government of Canada loans	82,858	—	82,858	84,798
Total long-term debt	$890,948	520,444	1,411,392	1,474,300

At December 31, 1985 it is estimated that required repayments of long-term debt over the next five years will be as follows:

	(000)
1986	$ 48,200
1987	78,100
1988	78,300
1989	127,700
1990	51,200

Details of long-term debt are as follows:

Hydro

Bonds, notes and debentures, redeemable at the option of Hydro at various times and at various rates, none of which exceeds 102-1/4% of par.

Interest Rate %	Year of Maturity		Foreign Funds	1985	1984	
			(000)	(000)	(000)	
5-1/4	1990	U.S.	$14,440	15,585	17,615	(a)
7-3/4	1993	U.S.	$25,000	26,773	26,773	(b)
9	1994	U.S.	$10,050	10,804	11,288	
9-3/4	1986	U.S.	$20,857	20,535	20,535	
8-1/8	1992			15,000	15,000	(b)
8-7/8	1999			20,000	20,000	(b)
10-3/4	1995			25,000	25,000	(b)
6-1/8	1992	S.Fr.	75,000	28,286	28,286	
10-1/4	2001			30,000	30,000	(b)
10	2002			30,000	30,000	(b)
10 Series J	2002			35,000	35,000	(b)
10-1/4 Series K	2001			35,000	35,000	(b)
10 Series L	2003			40,000	40,000	(b)
9-7/8	1994	U.S.	$50,000	57,797	57,797	
11-1/4 Series M	1999			110,000	110,000	(b)
13-3/8 Series N	2001			75,000	75,000	(b)
17-1/4	1989	U.S.	$75,000	88,876	88,876	
15-1/8	1992	U.S.	$100,000	124,072	124,072	
15-1/4 Series Q	1987			50,000	50,000	
11-1/4 Series R	1988			50,000	50,000	
7	1985	¥	7,000,000	—	37,934	
7-3/5	1995	¥	7,000,000	37,349	—	
				925,077	928,176	
Less sinking funds				86,391	69,259	
				838,686	858,917	
Less payments due within one year				30,596	10,061	
				$808,090	848,856	

(a) Secured by an assignment of amounts receivable under a power contract.

(b) A sinking fund has been established for this issue.

Government of Canada loans

These loans, in the aggregate amount of $84,798,000 (1984 $86,613,000), including the current portions, bear interest at various rates from 5-1/4% to 8-1/2% and each loan is repayable following the completion date of the related facility, by thirty or forty equal annual instalments including interest. The years of maturity of these loans range between 2003 and 2014, and the current portion as at December 31, 1985 was $1,940,000 (1984 $1,814,000).

Based on exchange rates in effect at December 31, 1985, the approximate amount required to discharge foreign currency debt obligations recorded in the accounts in Canadian dollars as $410,078,000 would be $512,957,000 (1984, as $413,176,000 would be $468,304,000).

CF(L)Co

	1985	1984
	(000)	(000)
First Mortgage Bonds		
7-3/4% Series A due December 15, 2007 (U.S. $386,749,000)	$408,728	426,443
7-7/8% Series B due December 15, 2007	38,761	40,428
General Mortgage Bonds		
7-1/2% due three years after latest maturity of any First Mortgage Bonds	88,585	90,393
	536,074	557,264
Less payments due within one year	15,630	16,618
	$520,444	540,646

The First Mortgage Bonds, Series A and B, are repayable in fixed semi-annual and in contingent annual sinking fund instalments which commenced in June 1978.

The Deed of Trust and Mortgage securing the General Mortgage bonds provides for semi-annual sinking fund payments which commenced in June 1980. Each payment will be equal to 1% of the aggregate principal amount outstanding on January 1, preceding each payment date. The General Mortgage Bonds are subordinate to the First Mortgage Bonds.

9. **Water Equalization**

On January 1, 1986 Hydro, having received the concurrence of the PUB, will implement a rate stabilization plan which includes a water variation provision component and the existing water equalization provision will be discontinued.

The balance of the existing water equalization provision of $30,267,000 will be utilized to extinguish a related receivable from the Government of $7,843,000 with the remainder being refunded to customers over a three year period.

10. **Guarantees by the Province**

The Province has unconditionally guaranteed the principal and interest on promissory notes and long-term debt, except for the Swiss franc loan and the debt of CF(L)Co.

11. **Sales of Power, CF(L)Co**

(a) The Power Contract provides for the sale of substantially all of the energy from the CF(L)Co Project for an initial period of 40 years, until 2016, with an automatic renewal for a further period of 25 years. Sales of power under the Power Contract have been recorded at mill rates based on a determination by an independent auditor that the Final Capital Cost of the Project is $887,575,000. Hydro-Quebec and CF(L)Co implemented an increase in rates during 1981 without prejudice to the right of either party in further negotiations or in a judicial review of the Final Capital Cost pursuant to the provisions of the Power Contract. CF(L)Co instituted proceedings in November, 1984 in the Quebec Superior Court claiming that the Final Capital Cost is in excess of $900,000,000, the maximum to be used as a basis for the mill rate. Hydro-Quebec filed a preliminary motion concerning whether CF(L)Co could institute the action, which motion was heard January 21, 1985. On February 11, 1985 the court upheld the preliminary motion and stated that it lacked jurisdiction over the subject matter of the action as drafted by CF(L)Co. CF(L)Co has appealed this judgment.

(b) The terms Energy Payable and Annual Energy Base are defined in the Power Contract. Section 8.5.2 of the Power Contract provides for an initial eight year review and subsequent four year reviews of the annual average Energy Payable for comparison with the Annual Energy Base then in effect. When the annual average Energy Payable exceeds the Annual Energy Base in effect an additional payment is due from Hydro-Quebec, the amount being calculated in accordance with Article VIII of the Power Contract. Conversely, if a shortfall should occur, a refund would be due from CF(L)Co to Hydro-Quebec. Article IX of the Power Contract provides for adjustment to the Annual Energy Base where applicable in the same time intervals.

Energy delivered to Hydro-Quebec during the period September 1, 1976 to August 31, 1984 was reviewed in September 1984 to determine the annual average Energy Payable for comparison with the Annual Energy Base in effect during the period. The annual average Energy Payable during the initial period was determined to be in excess of the Annual Energy Base, thereby resulting in an adjustment of $35,276,000 which amount includes interest. The Annual Energy Base was also reviewed pursuant to Article IX and was increased from 31.5 billion kilowatthours ("kW.hs") (Hydro-Quebec 30.74 billion kW.hs) per annum to 32.2 billion kW.hs (Hydro-Quebec 31.44 billion kW.hs) per annum, the maximum permissible under the Power Contract.

Included in the interest income in 1985 is $273,000 which is an estimate of the interest adjustment relating to that year to be determined in the first four year review of the Energy Payable and the Annual Energy Base.

12. **Interest Expense**

	1985	1984
	(000)	(000)
Gross interest		
Interest on long-term debt	$181,018	171,555
Interest on promissory notes	8,072	7,100
	189,090	178,655
Amortization of debt discount and financing expense	1,726	1,611
Exchange loss on sinking fund transactions and retirement of debt	177	5,249
	190,993	185,515
Less		
Recovered from:		
Hydro-Quebec (a)	26,798	23,541
PDD	4,134	3,730
Interest during construction	20,542	27,092
Interest earned	18,101	14,174
Net interest expense	$121,418	116,978

(a) Under the terms of the Power Contract, CF(L)Co recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt.

Also, CF(L)Co can require Hydro-Quebec to make additional cash advances to service its debt and to cover its expenses if funds are not otherwise available. In exchange CF(L)Co will issue units of Subordinate Debentures and shares of common stock.

13. **Commitments and Contingent Liabilities**

(a) (i) A request was made by the Province in 1976 for CF(L)Co to supply 800,000 kW of power, pursuant to Clause 2(e) of Part I of the lease, to meet the Province's requirements commencing in 1983. This request was denied and legal action was commenced against CF(L)Co. The trial of this action concluded July 8, 1982 and on June 13, 1983 the Newfoundland Supreme Court, Trial Division, denied the Province's request. This judgment was appealed to the Newfoundland Supreme Court, Court of Appeal which heard the appeal on October 15-18, 1984. On October 25, 1985, the Court of Appeal dismissed the Province's appeal. The Province applied to the Supreme Court of Canada on February 24, 1986 for leave to appeal this judgment. Judgment was reserved.

(ii) In June 1977, Hydro-Quebec commenced an action against CF(L)Co and the Province in the Superior Court in Montreal to obtain a declaration as to certain rights and obligations of the parties under the Power Contract. This action was dismissed on preliminary points of law in August 1977. The Court of Appeal of Quebec reversed the decision of the lower court and this decision was appealed by CF(L)Co and the Province to the Supreme Court of Canada which rendered its judgment on August 9, 1982. The Supreme Court of Canada decided that Hydro-Quebec could proceed against CF(L)Co, but not against the Province. Hydro-Quebec filed an amended motion seeking a declaration as to its rights under the Power Contract should CF(L)Co comply with the Province's request referred to in Note 13(a)(i). On August 4, 1983 judgment was rendered in which the Superior Court stated that, inter alia, failure by CF(L)Co to supply Hydro-Quebec all the power and energy pursuant to the Power Contract would be a breach of the Power Contract. The court declared

that compliance by CF(L)Co would be a default under the Power Contract. This judgment was appealed by CF(L)Co and on February 18, 1985 the Quebec Court of Appeal rendered its judgment dismissing the appeal. CF(L)Co applied to the Supreme Court of Canada on February 24, 1986 for leave to appeal this judgment. Judgment was reserved.

(b) Under the terms of a sublease with TWINCo, CF(L)Co is required to deliver to TWINCo, at an agreed price, horsepower equivalent to the installed horsepower of the TWINCo plant and to maintain in good working order, TWINCo's plant and equipment. The sublease expires on December 31, 1989 and has a 25-year renewal option subject to certain conditions.

(c) Hydro has received claims instituted by various companies with respect to construction costs, outages and plant shutdowns. The aggregate of these claims, less any amounts that have been provided for in Hydro's financial statements is $18,000,000 (1984 $16,000,000). The final resolution of these matters is currently under negotiation.

(d) Hydro's employees are covered by the Province's Public Service Pension Plan to which contributions are made equally by Hydro and its employees. CF(L)Co has two private pension plans, one for salaried and one for hourly paid employees and in addition a number of salaried and hourly paid employees are covered by the Public Service Pension Plan. Both CF(L)Co plans are fully funded and managed by a trustee. Based on the most recent actuarial valuations each CF(L)Co plan is in a surplus position.

(e) Hydro's outstanding commitments for capital projects total approximately $6,720,000 at December 31, 1985 (1984 $18,680,000).

14. **Comparative Figures**

Certain comparative figures have been reclassified to conform with the current year's presentation.

PEAT MARWICK

AUDITORS' REPORT

The Lieutenant-Governor in Council
Province of Newfoundland

We have examined the consolidated balance sheet of Newfoundland and Labrador Hydro as at December 31, 1985 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Peat Marwick Mitchell & Co.
Chartered Accountants

St. John's, Newfoundland
Canada
March 7, 1986

OPERATING STATISTICS

Years Ended December 31

	1985	1984	1983	1982	1981	1980	1979
Installed generating capacity at end of period (rated kW in thousands)							
CF(L)Co	5,403	5,225	5,225	5,225	5,225	5,225	5,225
TwinCo	225	225	225	225	225	225	225
Hydro - Hydroelectric	891	764	764	680	680	680	605
- Thermal	637	637	* 637	638	636	634	630
Total	7,156	6,851	6,851	6,768	6,766	6,764	6,685
Electric energy generated, net of station services (kW.h in millions)							
CF(L)Co	34,777	38,910	33,819	38,242	38,958	40,680	38,246
Hydro - Hydroelectric	3,449	4,086	3,912	3,134	3,387	2,403	2,355
- Thermal	1,725	757	575	1,121	414	1,350	1,148
Total Available for Sale	39,951	43,753	38,306	42,497	42,759	44,433	41,749
Electric energy sales (kW.h in millions)							
CF(L)Co - Export	31,833	35,989	31,188	35,715	35,881	37,759	35,221
Hydro - Utility	3,536	3,246	3,033	2,992	2,724	2,751	2,629
- Industrial	1,975	1,856	1,783	1,628	1,424	1,340	1,240
Total	37,344	41,091	36,004	40,335	40,029	41,850	39,090
Average sales revenue (cents per kW.h)							
CF(L)Co - Export	0.29	0.26	0.29	0.26	0.27	0.26	0.27
Hydro - Utility	4.44	3.63	3.12	2.98	2.42	2.22	2.03
- Industrial	3.79	3.02	2.89	2.60	2.22	2.05	1.94
Transmission lines (kilometres)							
CF(L)Co - 735 kV	608	608	608	608	608	608	608
- 230 kV	431	431	431	431	431	431	431
Hydro - 230 kV	1,531	1,531	1,408	1,353	1,326	1,191	1,191
- 138 kV	916	916	916	916	845	845	830
- 69 kV	539	539	539	455	443	347	347
Total	4,025	4,025	3,902	3,763	3,653	3,422	3,407
Peak demand (kW in thousands)							
CF(L)Co System	5,614	5,530	5,562	5,685	5,680	5,669	5,629
Hydro System	1,009	1,013	1,040	881	834	836	821

* Decrease in thermal capacity is result of shutdown of diesel generating plants in accordance with Hydro's ongoing interconnect program.

FINANCIAL STATISTICS

(in millions of dollars)
Years Ended December 31

	1985	1984	1983	1982	1981	1980	1979
Operating Results:							
Revenue							
Energy sales	$ 323.7	268.9	236.1	225.0	195.6	185.7	172.1
Rentals and royalties	5.4	8.5	4.9	5.3	5.9	6.1	5.5
Other	1.5	*37.0	1.8	2.3	1.8	2.0	2.2
	330.6	314.4	242.8	232.6	203.3	193.8	179.8
Expenses							
Operations and administration	51.1	52.7	47.4	48.1	40.4	36.3	32.3
Fuels	95.1	49.4	31.7	40.2	17.5	21.7	28.3
Depreciation	22.9	22.3	22.2	22.4	22.1	21.1	18.5
Interest	121.4	117.0	115.4	91.2	91.7	85.3	81.0
	290.5	241.4	216.7	201.9	171.7	164.4	160.1
Net income before minority interest	40.1	73.0	26.1	30.7	31.6	29.4	19.7
Minority interest	11.0	22.1	9.7	10.6	13.0	12.4	11.0
Net income	$ 29.1	50.9	16.4	20.1	18.6	17.0	8.7
Contributions to Net Income							
Hydro Corporate	$ 15.0	19.7	14.3	16.5	10.8	8.4	2.2
CF(L)Co	$ 14.1	31.2	2.1	3.6	7.8	8.6	6.5
Finanical Position:							
Total current assets	$ 140.4	135.4	112.3	183.4	144.3	95.2	111.2
Total current liabilities	224.2	168.5	147.0	121.2	108.2	125.8	88.7
Net working capital	(83.8)	(33.1)	(34.7)	62.2	36.1	(30.6)	22.5
Property, plant and equipment	2,141.8	2,108.2	2,011.9	1,864.1	1,712.4	1,599.4	1,519.7
Accumulated depreciation	241.5	218.4	197.5	174.8	152.4	130.6	112.7
Property, plant and equipment, net	1,900.3	1,889.8	1,814.4	1,689.3	1,560.0	1,468.8	1,407.0
Other assets	63.7	77.7	35.8	35.2	34.1	32.6	35.1
Long-term debt	1,411.4	1,474.3	1,427.7	1,425.5	1,296.8	1,177.9	1,298.8
Other liabilities	130.8	151.2	129.8	119.0	111.1	97.0	89.3
Shareholder's equity	$ 338.0	308.9	258.0	242.2	222.3	195.9	76.5
Employees at year-end:							
Permanent	1,196	1,197	1,213	1,232	1,205	1,204	1,194
Temporary	113	107	93	95	126	157	152
Total	1,309	1,304	1,306	1,327	1,331	1,361	1,346

* Includes unusual item relating to a sale of power adjustment of $35.3.

BOARDS OF DIRECTORS AND OFFICERS — 1985

DIRECTORS

NEWFOUNDLAND AND LABRADOR HYDRO

Cyril J. Abery, Vice-Chairman
Fintan J. Aylward, Q.C.*
Angus A. Bruneau
Lawrence D. Fahey
Janet C. Gardiner
Edward M. Hearn
Roland T. Martin
Moses O. Morgan
David A. Vardy**

* Resigned January 6, 1986
**Resigned May 10, 1985

CHURCHILL FALLS (LABRADOR) CORPORATION

Cyril J. Abery, Chairman
Guy Coulombe
Joseph Bourbeau*
James J. Greene, Q.C.
John P. Henderson
David W. Mercer
Michael J. Monaghan, Q.C.
Georges Lafond
Wallace S. Read**

* Resigned October 26, 1985
**Resigned May 31, 1985

LOWER CHURCHILL DEVELOPMENT CORPORATION

Cyril J. Abery, Chairman
A. Reiner Hollbach, Vice-Chairman*
Angus A. Bruneau
Charles Mariott‡
David W. Mercer
Wallace S. Read**
David A. Vardy***
Daniel E. Williams, Q.C.
Francis Fizzard

* Resigned January 17, 1986
** Resigned May 31, 1985
***Resigned May 10, 1985
‡ Appointed March 19, 1986

OFFICERS

NEWFOUNDLAND AND LABRADOR HYDRO

Cyril J. Abery, Vice-Chairman, President and Chief Executive Officer
David W. Mercer, Executive Vice-President
John P. Henderson, Executive Vice-President
Leo J. Cole, Vice-President, Engineering and Construction
R. Andrew Grant, Vice-President, Finance and Chief Financial Officer
T. David Collett, Vice-President, Operations
Derek W. Osmond, Vice-President, Rates and Corporate Services
Maureen P. Greene, Corporate Secretary and General Counsel
Robert D. C. Taylor, Treasurer
John C. Roberts, Corporate Controller
Frank A. Wright, Assistant Corporate Secretary
George N. Gray, Assistant Treasurer

CHURCHILL FALLS (LABRADOR) CORPORATION

Cyril J. Abery, Chairman and Chief Executive Officer
John P. Henderson, President
David W. Reeves, Vice-President, Operations and Engineering
R. Andrew Grant, Vice-President, Finance and Chief Financial Officer
Maureen P. Greene, Corporate Secretary and General Counsel
Frank A. Wright, Assistant Corporate Secretary
Robert D. C. Taylor, Treasurer
George N. Gray, Assistant Treasurer
John C. Roberts, Corporate Controller

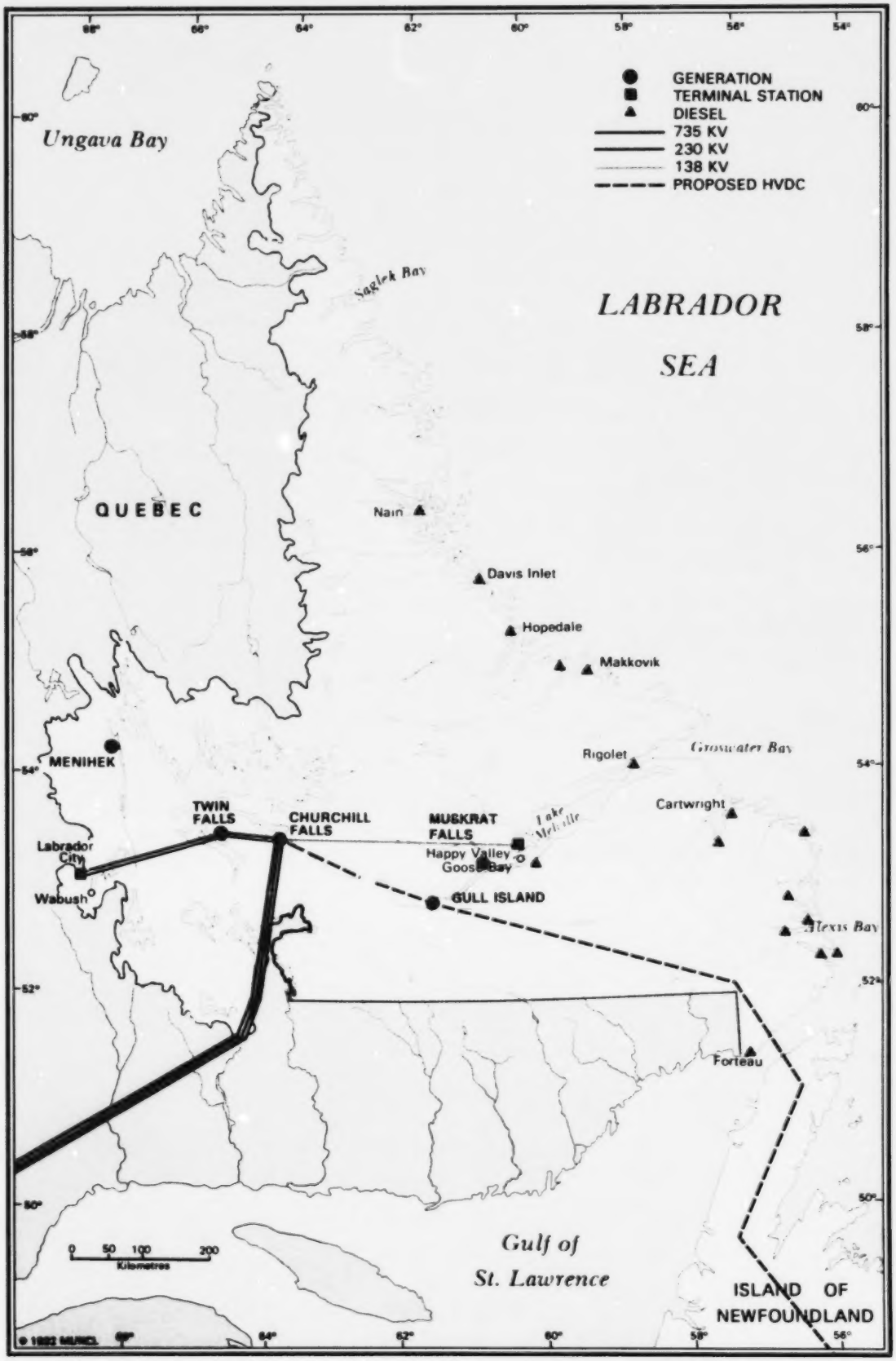
LOWER CHURCHILL DEVELOPMENT CORPORATION

Cyril J. Abery, Chairman
David W. Mercer, President and Chief Executive Officer
Maureen P. Greene, Corporate Secretary
Charles Mariott, Vice-Chairman*

*Appointed March 19,1986

POWER DISTRIBUTION DISTRICT OF NEWFOUNDLAND AND LABRADOR

Cyril J. Abery, Chairman
T. David Collett, Vice-Chairman
Leo J. Cole, Member
R. Andrew Grant, Member
Garland W. Jennings, Member
David W. Mercer, Member
Maureen P. Greene, Corporate Secretary
Frank A. Wright, Assistant Corporate Secretary


GENERATION
TERMINAL STATION
DIESEL
735 KV
230 KV
138 KV
PROPOSED HVDC
Ungava Bay
Saglek Bay
LABRADOR
SEA
QUEBEC
Nain
Davis Inlet
Hopedale
Makkovik
Rigolet
Groswater Bay
MENIHEK
TWIN FALLS
CHURCHILL FALLS
MUSKRAT FALLS
Lake Melville
Cartwright
Labrador City
Happy Valley
Goose Bay
Wabush
GULL ISLAND
Alexis Bay
Forteau
Gulf of
St. Lawrence
ISLAND OF
NEWFOUNDLAND
0 50 100 200
Kilometres
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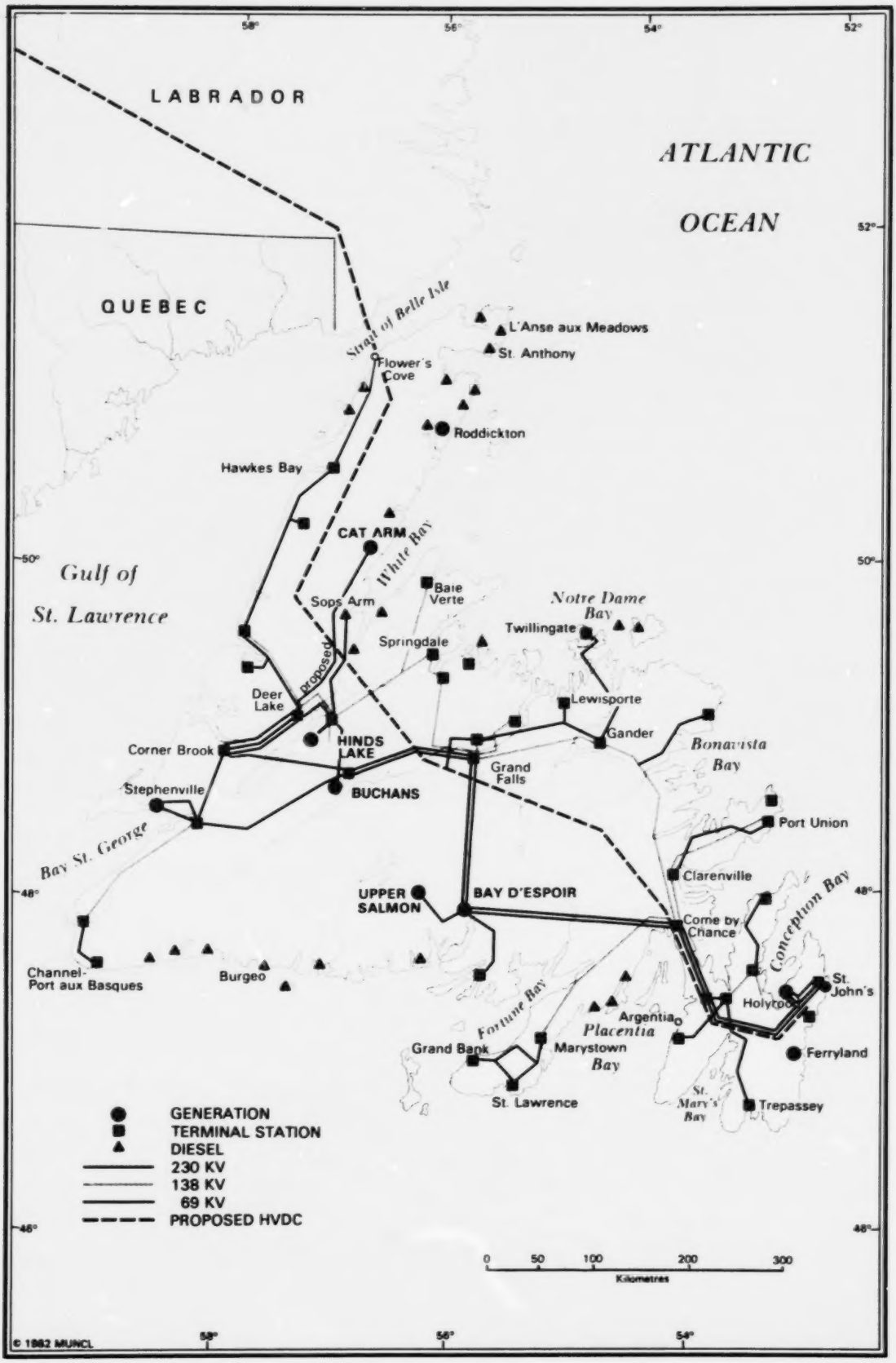
LABRADOR
ATLANTIC
OCEAN
QUEBEC
Strait of Belle Isle
L'Anse aux Meadows
St. Anthony
Flower's Cove
Roddickton
Hawkes Bay
CAT ARM
White Bay
Gulf of
St. Lawrence
Baie Verte
Sops Arm
Notre Dame Bay
Twillingate
Springdale
Proposed
Deer Lake
Lewisporte
Gander
Corner Brook
HINDS LAKE
Bonavista Bay
Grand Falls
Stephenville
BUCHANS
Port Union
Bay St. George
Clarenville
UPPER SALMON
BAY D'ESPOIR
Come by Chance
Conception Bay
Channel-Port aux Basques
Burgeo
St. John's
Holyrood
Fortune Bay
Argentia
Placentia Bay
Grand Bank
Marystown
Ferryland
St. Lawrence
St. Mary's Bay
Trepassey
GENERATION
TERMINAL STATION
DIESEL
230 KV
138 KV
69 KV
PROPOSED HVDC
0 50 100 200 300
Kilometres
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